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INTERNATIONAL FREIGHT TRANSPORT SERVICES

SUBMISSION TO THE NEW ZEALAND PRODUCTIVITY COMMISSION

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BACKGROUND

The Institution of Professional Engineers New Zealand (IPENZ) is the lead national professional body representing the engineering profession in New Zealand. It has approximately 12,000 Members, including a cross-section from engineering students, to practising engineers and senior Members in positions of responsibility in business. IPENZ is non-aligned and seeks to contribute to the community in matters of national interest, giving a learned view on important issues, independent of any commercial interest.

CONSULTATION

A draft version of this submission was provided to all IPENZ Members via the IPENZ website. In addition, interested Members were sent the draft submission directly. All IPENZ Members were able to comment on the submission and Members' comments are included in this version.

SUBMISSION

1. WHAT HAS THE COMMISSION BEEN ASKED TO DO?

Question 1. Are there important issues that may be overlooked as a result of adopting an economic efficiency perspective for this inquiry?

The efficiency of freight transport services is very important for economic growth and lifting productivity, but it is widely recognized that this is not the sole decision making framework for governments. Consideration must be given to wider economic benefits beyond the freight transport system, the impacts on our natural environment, and the social impacts on communities. It is acknowledged that the Terms of Reference of this Inquiry are confined to economic efficiency, but we believe the Commission should recognise the wider societal context within which the freight transport system operates.

Question 2. Is the framework described in Section 3.2 appropriate for this inquiry? Are there any important issues that might be missed?

The framework – Figure 2 refers to sea transport and air transport –acknowledges international transport is dependent upon domestic road, rail, and sea freight transport networks. However the Issues Paper analysis is confined to ports and airports and does not devote any analysis to the wider domestic freight transport infrastructure network’s contribution as a component of the international freight transport network. The Commission’s Terms of Reference do not support taking such a narrow perspective of freight supply chains.

This is a significant oversight and highlights the compartmentalised approach to improving efficiency and productivity taken in the past. The freight network needs to be considered in a holistic manner as an integrated and interdependent whole – and this is discussed further below under the section on the logistics chain. Competition between modes is no longer the relevant factor – competition between supply chains is.

Question 4. What environmental considerations should fall within the scope of this inquiry?

The Issues Paper explains that *“if environmental costs are incorporated in input prices then individual decision makers seeking to lower their own costs should also lower environmental costs. The quest for improved productivity – increased output for the same inputs – is entirely compatible with environmental considerations. Problems can be expected when prices do not adequately reflect environmental costs”*.

The Issues Paper discusses the emissions trading scheme, but in New Zealand this is the only priced element of environmental externalities. New Zealand also has international green house gas emissions obligations and targets which are challenging. The Commission also needs to consider how any of its recommendations might impact on future emissions, and whether these will contribute or undermine the achievement of national targets.

The environmental impacts of freight infrastructure development are largely managed by the provisions of the Resource Management Act 1991, and by recent amendments to the Act that improved resource consent processes for projects of national significance.

The Productivity Commission might consider whether there would be a benefit in a National Policy Statement (NPS) or National Environmental Standards (NES) for ports or airports, similar to the NPS for electricity transmission. A NPS would provide guidance for local authorities to decide how competing national benefits and local costs should be balanced and the NES would assist in ensuring consistent approaches and resource consent decision-making processes throughout the country. For example these mechanisms could assist in providing a level playing field for competing ports.

2. EFFICIENCY OF INDIVIDUAL COMPONENTS

2.1 PORTS

Question 13. What levels of investment have ports undertaken in recent years? Are they consistent with accessible and efficient services to exporters and importers? Is there an over- or under-investment problem in ports?

A Member has advised that further investment in ports is needed. In his view many wharves in New Zealand ports are under the strength required to allow the loading of vessels using heavy plant. As the end-of-life of these wharves approaches, replacement options for them and their land approaches may require significant upgrading or stronger rebuilds to accommodate this heavier plant.

Also, the Member's advice is that the move to larger vessels by shipping companies servicing the New Zealand trade will require significant investment in channel and berth dredging in a number of areas.

Question 15. Has local-authority ownership of majority stakes in New Zealand's commercial ports inhibited, enhanced or been neutral for the development of a more efficient and productive port sector?

The legislation for ports is the Port Companies Act 1988. Under the provisions of Section 5 port companies are required to operate as successful businesses. However ports have some specific characteristics:

- The expansion of ports is often constrained by being located close to inner city areas (and residential) areas – particularly in Auckland
- The contraction of ports can result in stranded capital investment in infrastructure
- Port closure is often irreversible and this is problematic should new export industries develop in future years
- Ports are not usually relocatable as they are dependent upon deep water, protection from ocean swells and access to other infrastructure
- Large New Zealand export companies such as Fonterra dictate port, road and rail freight expansion and contraction. Examples include changes to dairy and coal export volumes
- Infrastructure investment is long term and yet is made in a dynamic market
- Increasing port activity can have wider regional economic and social benefits
- Port businesses have some characteristics of natural monopolies – i.e. there are high barriers to new market entrants.

These characteristics suggest that in addition to being commercial enterprises, there are wider public interests in ports. These include their unique locations, the irreversibility of closure, the need for long term investment, their regional benefits and their monopoly characteristics. In any proposals for change we suggest the Commission carefully consider these public interests.

Question 23. Would the Commerce Commission be better placed than the Minister of Transport to oversee the regulation of international shipping services?

In our view the Commerce Commission would be best placed to over-see the regulation of shipping services, as most of the issues are competition related.

A particular issue IPENZ has is in the adequacy of reporting by infrastructure entities, including ports and airports.

It can be argued that these infrastructure businesses deliver critical services and are "too big to fail" and there is therefore a public interest in ensuring the business will continue to reliably deliver these critical services in the future. The Ministry of Economic Development discussion paper, in relation to economic significance, states:

"The idea underpinning economic significance as an indicator is the economic or social impact that a large entity is likely to have on the national or a regional economy if it fails. There is, therefore, a broader stakeholder interest in the financial position and performance even if they do not have public accountability".

Although this statement refers to financial reporting, IPENZ believes transparent non-financial performance information should also be provided by all network infrastructure

organisations, including privately owned organisations. It is suggested that this public interest outweighs the interests of protecting the companies' commercial sensitivity. Since this information is at the outcome level, and would not include operational strategies or activities, the likelihood of this information being useful to competitors is small.

IPENZ published a report in August 2010 on this issue – Assessing the State of Infrastructure – and this involved analysing past annual reports of TranzRail, Transpower and Transit NZ. The recommendations were that in annual reports:

- Separate information be provided on maintenance, renewal and capital expenditure for key asset categories
- Significant improvement in performance indicators for levels of service be promoted by government oversight agencies
- Performance indicators be related to outcomes, include current and future targets, and be consistent from year to year showing trends over time, so the level of preparedness for providing services in the future can be assessed
- Additional asset information be provided on remaining useful lives, replacement levels, asset condition and capacity assessments, and risk assessments
- Private sector organisations providing critical infrastructure be required to provide statements of service performance due to the public interest in ensuring the future continuity and reliability of services.

We suggest the Commission consider whether the current disclosure requirements for ports and airports adequately address these matters due to their regional and national economic significance.

2.2 AIRPORTS

Question 28. Do current ownership and governance arrangements of New Zealand's international freight airports have any significant positive or negative effects on their long-term efficient configuration and operation, with respect to the supply of freight services?

Airports have similar characteristics to ports – expansion is constrained, closure is irreversible, they are not readily relocatable (need a large area of flat land), have wider regional economic and social benefits and have some natural monopoly characteristics.

Question 30. What levels of investment have Auckland and Christchurch airports undertaken in international freight, and are they consistent with accessible and efficient services for New Zealand exporters and importers?

In our view the air side system involving airports and airlines works extremely well with capacity usually matching demand. This is unlike land transport systems that often have mismatches between capacity and demand.

Question 34. Is the existing and planned Commerce Commission regulation of airports sufficient to restrain monopoly pricing and induce an efficient level of investment?

Under Section 4A of the Airport Authorities Act 1966 airport authorities may set charges as it thinks fit. The Commerce Commission completed an inquiry in 2002 on whether airfield activities should be controlled at the three major international airport companies at Auckland, Wellington and Christchurch. The Commission found the three airports faced limited competition in their relative geographic markets for providing airfield

services. While the Commerce Commission promulgated additional disclosure requirements on financial and non-financial information in December 2010, the airline industry still believe that under current arrangements airports will continue to overcharge.

In addition IPENZ has a particular interest in the adequacy of annual reporting of infrastructure businesses. This is discussed in the response to Question 23 above.

2.3 ROADS

Roads are owned by Government and local government and are funded largely by fuel excise and road user charges (a proxy for user pays). Half the funding for local roads is from rates (equivalent to local land taxes). As an indication of the nature of the network, 17 per cent of total kilometres travelled are on less than 1 per cent of the total road network, 88 per cent of roads are local roads, and a third of roads are unsealed. This suggests that our major parts of our economy are reliant on low volume roads in the rural hinterland.

IPENZ has been concerned about the analysis behind a number of recent Government decisions:

- The original selection and upgrading of roads of national significance was not based on an analysis of the roads that would make the greatest contribution to productivity
- The original decision to introduce permits for “high-productivity motor vehicles” (HPMV) to operate on approved routes at greater dimension and mass limits did not include an analysis of the impacts on road and bridging infrastructure
- The decision to reduce maintenance and renewal funding forecasts by 30 per cent on state highways and local roads in the recently released Government Policy Statement on Land Transport funding was not based on any analysis of the impacts on road infrastructure and productivity.

To maintain New Zealand’s international competitiveness and increase our economic earning capacity from the primary industries, farming and forestry have made and continue to make efficiency gains in production processes. The fundamental gain is through: increased economies of scale. Farming has become more intensive, particularly through conversions to dairying; use of irrigation that has allowed year round production and higher production; increased mechanisation that has allowed greater production with similar labour input.

The outcome of this is that larger, heavier and more mobile machinery is being used, and the local roads accessing these farms were never designed for such vehicles. Both road renewal and maintenance demands are thus increasing.

Therefore, in the absence of an analysis on the implications of these reduced funding forecasts, it is possible that freight productivity improvements may be undermined by a deteriorating roading network in the future.

2.4 RAIL

IPENZ is supportive of the Government’s Turnaround Plan for KiwiRail to upgrade rail infrastructure and rolling stock to help increase New Zealand’s economic productivity and growth. IPENZ also recognizes that elements of the network are uneconomic and may need to be closed. The decisions to close particular lines need to be taken with care – these decisions are often irreversible, and closure can erode wider network profitability. Line closures also impact on other components of the supply chain such as ports.

3. EFFICIENCY OF INTERFACES BETWEEN COMPONENTS

Question 57. Should decisions on investments in ports and in the associated infrastructure links to ports be left to the judgements of the individual suppliers of the separate components? Or would some sort of overall strategic plan provide useful guidance and some assurance that complementary investments will happen?

The major regional councils undertake multimodal transportation modelling and planning and these play a major part in designing the transport networks in metropolitan areas. This modelling includes specific localised freight analyses. Modelling is a sophisticated planning tool that uses a range of criteria to design and future proof (through scenario testing) a desirable and integrated transport network. Through this process the network can be designed to seek to achieve a range of objectives including those enabling regional economic growth, the efficient use of public capital, affordability, improving accessibility, and minimising environmental impacts.

Therefore a regional transport plan that recognises the freight supply chain's interdependent components, developed in an inclusive way, can provide a context for development by both public and private infrastructure providers, and are a valuable tool for assisting with commercial investment decision making.

Similarly the Ministry of Transport undertook the National Freight Demands Study in 2008. This provided valuable information on existing and future freight demands.

Thus information and analysis by public agencies can be very useful for the private sector.

An interesting suggestion in the 2004 Infrastructure Stocktake recommended to Cabinet the concept of "facilitated discussions" between by central government, local government and private sector and infrastructure users and providers. This could be effective in bringing together the common issues – freight infrastructure development is driven by similar growth demands.

4. EFFICIENCY OF THE LOGISTICS CHAIN

Question 73. What is the best way to achieve efficient decisions and coordination for the large, lumpy and interdependent investments that typically occur along international freight supply chains?

Question 74. What factors would favour the choice of decentralised vs. centralised strategic planning?

4.1 PRINCIPLES FOR ACHIEVING EFFICIENCIES

The logistics chain from farm or factory to the international customer is complex and each of its interdependent transport modes have different ownership models (public and private), different funding mechanisms (Government and users) and different regulatory regimes.

In our view the principles that ideally should drive improved efficiencies in these complex freight networks are:

4.1.1 Pricing.

Many argue that if the prices are right (including externalities and the cost of capital), this will drive economically efficient outcomes. Each of the transport modes have different environmental impacts – noise, water quality, air quality and pricing mechanisms could capture these differences. The Ministry of Transport undertook the

Surface Transport Costs and Charges study in 2007 but this did not extend to sea transport. In theory pricing would place all transport modes on a level playing field. The Productivity Commission should consider whether improving pricing signals is feasible across all modes in the medium term. It seems that there is increasing acceptance of toll roads, but any form of congestion pricing or road network pricing would appear to be some years away.

4.1.2 Neutrality of public funding

Roads and rail are often competing modes for the freight business and this raises the problematic issue of the different government support for road and rail to meet the demands of the growing “freight task”. Recognising the issues with implementing pricing mechanisms, the Commission must consider whether Government (and local government) funding mechanisms are neutral and do not favour one mode over the other.

Further, commercial disciplines, investment decision making and financial reporting mechanisms (including balance sheets) are not applicable to the roading network. As a result of this and the acknowledged difficult funding allocation issues, there are inevitably cross subsidies between light vehicles and freight transport.

4.1.3 Regulatory consistency.

There are considerable differences in the regulatory regimes for the various the modes including:

- **Rates of Return** – shareholders expect a return on investments in rail, port and airports but it is not expected on the nation’s road network.
- **Safety** – existing regulation under the Railways Act imposes compliance costs on rail - for example an industry must have a rail safety case if it is to perform even basic movement of rail vehicles on its site. The aviation industry also has very significant compliance safety related costs.
- **Site access** – rail also faces a different regulatory regime to road – for example a factory needs to have a rail service license to move wagons around a site.
- **Labour market and safety legislation** – international shipping businesses operating on the New Zealand coastline are seemingly free from aspects New Zealand employment legislation and Health and Safety legislation.

4.1.4 Interagency co-ordinated planning

Centralised planning and de-centralised planning are not necessarily mutually exclusive. As explained above in our response to Question 57 a regional plan can valuable information on future regional demographic and economic forecasts and on proposed land transport infrastructure improvements. This provides a wider context for the individual investment decisions by freight infrastructure owners and freight operators.

4.2 OVERVIEW OF THE SUPPLY CHAIN

The freight supply chain consists of both infrastructure and operators. The model in New Zealand is for freight infrastructure to be in at least partial public ownership and for freight operators to be private businesses. The exception is Kiwirail which is both an infrastructure owner and an operator. Overall this model of public ownership of infrastructure and private ownership of operations has some merit, as freight infrastructure has a number of monopoly characteristics, and operators are generally in highly competitive markets.

Some argue that ports are cash cows for local authorities, and as discussed above airlines have ongoing concerns about the charges imposed by airports. Thus both public and private owners can be accused of exploiting their monopoly positions, which is why some form of regulation is needed. There are arguments that disclosure requirements may not be sufficient and the public interest in infrastructure can be protected either by economic regulation (when in private ownership), or by public ownership. Economic regulation, such as rate of return or price regulation, is not common in New Zealand except for lines companies, but is now evolving for telecommunication networks. Economic regulation of monopolies is common overseas.

We can only suggest that the Commission carefully weigh up these issues, and consider the extent of regulation needed to ensure prices are both fair and provide sufficient revenue to allow for ongoing capital investment.

CONCLUSION

IPENZ appreciates the opportunity to make this submission and can provide further clarification if required.

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